Alan F. Ciamporcero
Executive Director

Federal Regulatory Relations
1275 Pennsylvania Avenue, N.W., Suite [illegible]
Washington, D.C. 20004
(202) 383-6416

PACIFIC TELESIS
Group-Washington

January 31, 1995

RECEIVED
JAN 31 1995
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

Dear Mr. Caton:

Re: *CC Docket No. 94-1, Price Cap Performance Review for Local Exchange Carriers*

On behalf of Pacific Bell, please find enclosed an original and six copies of its *"Comments on USTA Proposal"* in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,

Alan Ciamporcero

Enclosures

No. of Copies rec'd 0+5
List A B C D E

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

RECEIVED
JAN 3 1 1995
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of Price Cap Performance Review for Local Exchange Carriers	CC Docket No. 94-1

DOCKET FILE COPY ORIGINAL

COMMENTS ON U.S.T.A. PROPOSAL

In accordance with the Commission's Public Notice dated January 24, 1995 (DA 95-102), Pacific Bell ("Pacific") hereby comments on the "USTA Proposal for the LEC Price Cap Plan," filed January 18, 1995 (the "USTA Proposal").

We support USTA's proposal. The following merely states what we believe should be the Commission's priorities in this proceeding.

(1) Eliminate sharing. Rate of return (ROR) regulation gives LECs incentives to behave inefficiently and anticompetitively. Sharing and earnings caps preserve these incentives. Indeed, the more efficient a LEC tries to be, the more likely its earnings will reach into the zone of 100% sharing where the difference between ROR and price cap regulation disappears.

These relics of ROR regulation conflict with multiple public policy goals. But in particular, sharing and earnings caps are utterly irreconcilable with a policy of promoting competition in interstate access. First, they cause the interests of LECs and their competitors to intersect in ways that can only bedevil policymakers. A LEC with earnings in the 50-50 sharing zone shares half of each dollar of interstate revenue and half the corresponding expenditures with its competitors the IXCs. Thus MCI recently objected to our Education First proposal because the cost of wiring the schools might reduce sharing--a good example of the tail wagging the dog.[1] Second, as the D.C. Circuit put it,

> rate-of-return regulation creates incentives for cost shifting that may defeat the regulatory purpose and have other ill effects. Firms can gain by shifting costs away from unregulated activities (where consumers would react to higher prices by reducing their purchases) into the regulated ones (where the price increase will cause little or no drop in sales because under regulation the prices are in a range where demand is relatively unresponsive to price changes).[2]

As long as sharing coexists with competition, every contribution we could make to reducing consumer prices and increasing consumer choices--be it cable, long distance, or simply interstate access choices--will be met with the objection that we might cross-subsidize. To respond to this objection requires the Commission in turn to monitor our costs, our separations, our allocations, our depreciation rates, and all of our other accounting practices, just as it had to do

---

[1] See *Pacific Bell Petition for Interim Waiver of Part 69.104,* Comments of MCI, filed December 8, 1994.

[2] *National Rural Telecom Ass'n v. FCC,* 988 F.2d 175, 178 (D.C. Cir. 1993).

under ROR regulation. As if the dizzying pace of change in markets and technology did not tax the Commission enough.

For the most part, earnings shared with IXCs are neither passed through to consumers nor reinvested in American networks. We recently experienced this firsthand in California. IntraLATA toll competition began here on January 1, 1995. We immediately reduced our average access charge by more than 50%. For a four minute, 80 mile call, our average access rate for originating and terminating the call fell from $.23 to $.11 (rounded to the nearest cent). AT&T, whose cost of carrying this call thus fell by twelve cents, passed along a one cent reduction to the caller who pays its interLATA rack rate. The CPUC's Division of Ratepayer Advocates responded: "only the IECs and their shareholders will be receiving the full benefits of the switched access charge reductions, and not ratepayers who use interLATA services ... the IECs appear to be leveraging their market power in the interLATA market to sustain lower rates in the intraLATA market."[3]

If sharing is not eliminated in the first order to emerge from this proceeding, the Commission will have accomplished little or nothing to benefit consumers or promote competition.

---

[3] Letter from Jeffrey P. O' Donnell, Division of Ratepayer Advocates to Jack Lentza, Chief, Telecommunications Branch, CPUC, December 21, 1994.

There is one pitfall the Commission must beware even if sharing is eliminated. That pitfall is adopting a productivity measure that simply measures changes in earnings and thus recreates the effects of sharing.

(2) Take Immediate Steps Toward Access Reform. In Attachment 2 of its Proposal, USTA recommends the initial order "deal with those elements of a new framework which do not require specific conclusions regarding the degree of competition in access markets." USTA Proposal, Att. 2, p. 1. These steps are so obvious that no further record is needed to adopt them, and no reasonable person could deny they would enhance interstate access competition. Consumers would benefit immediately from these steps through lower prices and greater choices. In our own Attachment to these Comments, we elaborate.

(3) Gather the Data Needed For a Further Rulemaking. Ample precedent exists to grant the pricing flexibility that USTA has requested. The Commission has not only treated AT&T's different baskets as different de facto markets, it has allowed AT&T to create market classifications of services within the baskets and remove them from price cap regulation by making a competitive showing.[4] But even to decide whether this could be done in interstate access markets, the Commission needs information that we do not have.

---

[4] See, for example, *Revisions to Price Cap Rules for AT&T,* CC Docket No. 93-197, *Report and Order,* FCC 95-18, released January 12, 1995, para. 15. It is therefore particularly ironic that AT&T assumes "interstate access" to be one undifferentiated market.

As the Commission has repeatedly recognized, an analysis of competition within a market requires information not only about market share in the relevant market, but elasticity of supply, and elasticity of demand.[5] The Commission has determined that various long distance services are competitive based mainly on IXC minutes of use that passed through our switches.[6] Trying to determine what interstate access markets are competitive based on usage figures from our network would be a useless and circular endeavor: the whole point is to measure the usage that is <u>not</u> on our networks.

The Commission should request under authority of Sections 219 and 220 that all providers of access service provide descriptions or maps of areas they serve. These must be specific enough for the Commission to determine in what areas customers may, with minimal effort, address their traffic to the

---

[5] *Id.*, paras. 17-26.

[6] See *id.*, paras. 17-18.

access networks of our competitors. Without that information, no meaningful conclusions may be drawn about the extent of access competition.

With these additional comments, we support USTA's latest proposal.

Respectfully submitted,

PACIFIC BELL

John W Bogy

JAMES P. TUTHILL
JOHN W. BOGY

140 New Montgomery Street, Rm. 1530A
San Francisco, California 94105
(415) 542-7634

JAMES L. WURTZ

1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
(202) 383-6472

Its Attorneys

Date: January 31, 1995

- COMBINE DS1 AND DS3 SERVICE CATEGORIES

  - The Commission recognized in the LEC price cap order that similar services should be grouped together.

  - These services are largely interchangeable and employ the same technology.

  - The DS3 product line has matured since the separate subindices for DS1 and DS3 were ordered. There are currently more DS3's in service relative to DS1's in service than when the current price cap structure was adopted. This reduces the ability to offset DS3 price reductions with large DS1 price increases.

- INCREASE DOWNWARD PRICING FLEXIBILITY TO 15% FOR ALL SERVICE CATEGORIES

  - Better enables LECs to respond to competition. More significant price reductions could be on 14-days' notice rather than the current 45-days' notice required for "below band" filings for changes of 5% or more.

  - Promotes more rapid price reductions to consumers which enhances economic efficiency. Annual price reductions could be more rapid since currently reductions are held to 5% per year.

  - The LRIC antitrust standard prevents concerns over predation.

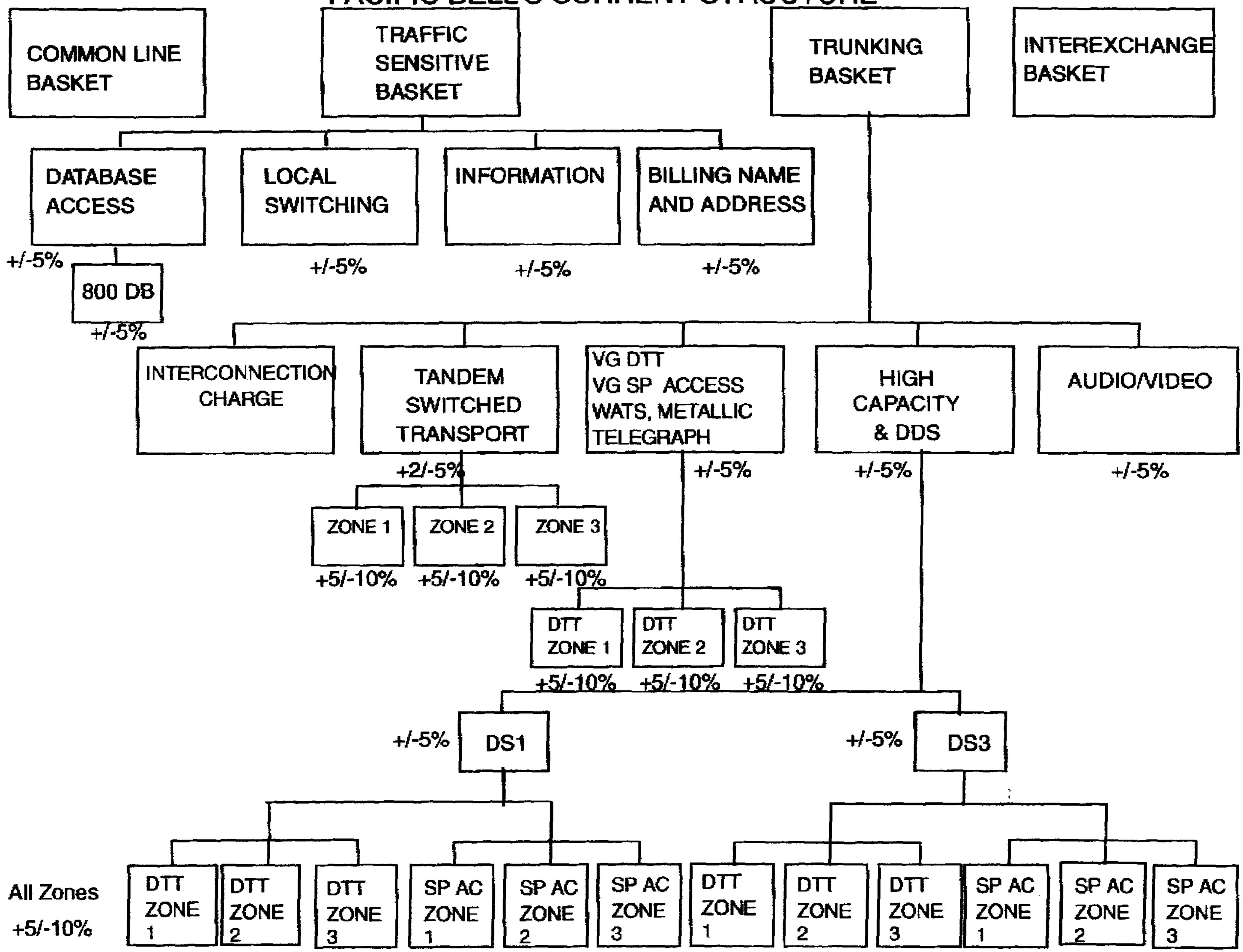
- IMPLEMENT DENSITY ZONES FOR LOCAL SWITCHING AND DDS SERVICE CATEGORIES

  - Local switching is subject to economies of density.

  - Density zones will reduce the incentive for customers in densest areas to move off the public switched network to dedicated or private alternatives.

  - DDS is part of the digital product continuum and should be included with other digital services.

PACIFIC BELL'S CURRENT STRUCTURE



PACIFIC BELL'S PROPOSED 94-1 INITIAL ORDER